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District Director
Burlington, Vt 05401

Assistant Chief Counsel (Income Tax and Accounting) CC:IT&A

Prepaid Funeral Trust Accounts

This is in response to your memorandum of August 5, 1988, in which you request technical assistance in determining the correct taxpayer identification number for prepaid funeral trust accounts and whether such accounts are subject to backup withholding under section 3406 of the Internal Revenue Code.

Under Rev. Rul. 87-127, 1987-2 C.B. 156, prepaid funeral trusts are to be treated as grantor trusts and, accordingly, the purchaser (and owner of the trust) must pay tax on income earned by the trust.

Currently, under section 301.6109(a)(1) and (2) of the regulations on Procedure and Administration, a trust must obtain an EIN, and an individual grantor must provide a social security number to the trustee. You have indicated in your memorandum that this is being done.

Under current law, the payor of interest income is required to provide a Form 1099 to the trust. Although the income is reported by the grantor on the grantor's Form 1040, the trust must file a Form 1041 with an attached statement showing income and deductions. See section 1.671-4 of the Income Tax Regulations.

Under Q&A-20 35a.9999-2 of the Temporary Employment Tax Regulations, payors of payments made to a grantor trust are subject to the general rules of backup withholding. Therefore, a payor bank would only backup withhold if the trust failed to meet any of the backup withholding rules, such as failure to certify its EIN. However, separate rules are provided for grantor trusts, which depend upon the number of grantors in the trust.

Under section 31.3406(h)-2(c)(2) of the Proposed Employment Tax Regulations, (published in the Federal Register Sept. 27, 1990) a grantor trust with ten or fewer grantors is not considered a payor. Therefore, distributions by the trust of amounts to the grantors are not considered payments of reportable amounts subject to backup withholding. However, backup withholding will apply to a reportable payment to such a grantor

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trust established on or after January 1, 1984, if one of the conditions for imposing backup withholding exists with respect to the trust.

Under section 31.3406-(h)-2(c)(3) of the proposed regulations, grantors trusts with more than ten grantors are considered payors of reportable payments received by the trust for purposes of backup withholding. Each grantor of such a trust is treated as having received his or her proportionate share of the reportable payment on the day the payment is received by the trust. Therefore, any reportable payment made to the trust is treated as a reportable payment made by the trust to the grantor and is subject to backup withholding if one of the specified conditions exist with respect to the grantor.

We apologize for the long delay in responding to your questions. We are currently drafting regulations that may change reporting requirements for grantor trusts and had hoped to have published them before now. Mary Jane Kossar is the initiator of the proposed regulations and can be reached at FTS 566-3453. She will keep you informed of what the proposed regulations will have.

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By: (signed) Norlyn D. Miller
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